No. 9015

IN THE

United States Circuit Court of Appeals

FOR THE

Ninth Circuit

PACIFIC STATES SAVINGS & LOAN COMPANY, a Corporation, Substituted for Reconstruction Finance Corporation, *Appellant,*

vs.

LEO F. SCHMITT, As Receiver of Bank of Nevada Savings & Trust Company, Carson Valley Bank, Tonopah Banking Corporation, and Virginia City Bank, *Appellees.*

PETITION FOR RE-HEARING

PLATT & SINAI,
Attorneys for Appellees.

SUBJECT INDEX

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NOW COME the above-named appellees and respectfully petition the above-entitled court for re-hearing herein

upon the following grounds and for the following reasons:

1.

The Court, In Its Opinion, Did Not Pass Upon Appellees' Point, Raised In the Brief, That the Suit Is Inequitable and Unconscionable

This contention was urged in appellees' pleading in the trial court, was advanced upon the trial, and orally argued upon appeal. May we presume further to clarify the point as follows:

The common directorate managed both banks. As such, it owed an equal duty to the depositors of both banks. This obligation carried with it a requirement that good and sufficient security be demanded for money loaned out of either or both banks. The responsibility for the sufficiency of this security rested with the common directorate. The definite acceptance of security for depositors' money loaned from either bank was notice to the depositors that by duty, morals, and law, the common directorate was conscientiously attempting to protect their deposits. The depositors were justified in feeling secure that after their money had passed to a borrower, the common directorate could not later repudiate the security and leave them without protection. If these assertions be convincingly correct, then this suit by the successors of a common directorate, not only to repudiate the security, but to pass it over for the benefit of the other bank over which

it had equal supervision, is a glaring example of unfairness, double-dealing, duplicity, and implied fraud.

Here, the common directorate approved two mortgages as good and sufficient security for a $700,000 loan from the Reno National Bank. They must be assumed to have known what the mortgages provided and what property they encumbered. With this knowledge, THEY MUST HAVE CONCLUDED THAT THE STOCK IN QUESTION HERE WAS NOT PLEDGED BY EITHER MORTGAGE, FOR THEY ACCEPTED THE STOCK AS GOOD COLLATERAL FOR THE LOAN FROM THE OTHER BANK. Their every official action in handling both loans proves this. Never once, while the banks were open, so far as the record discloses, was the validity of this stock security for the Bank of Nevada loan ever questioned or assailed. With knowledge of the common directorate, it passed every directors' meeting of both banks and every Federal and State bank examiner. After the depositors' money was handed over the counter, the stock-collateral was in no other place but in the vaults of the Bank of Nevada. The common directorate always treated and considered it as pledged to this bank. Their authorized Vice-President and General Manager of the Reno National Bank, Jerry Sheean, personally witnessed the endorsed signature of Taylor, by which the stock-collateral was deposited with the Bank of Nevada. It was approved and accepted by him, and he even endorsed upon the notes the purpose

for which the money loaned was to be used. Never once, so far as the record shows and while the banks were open, did the Reno National ever make a demand upon the Bank of Nevada for this stock. Never once during this time, was it ever hinted or suggested that the stock was included in these mortgages. It has been carried continuously up to this very day on the books of the Bank of Nevada as an asset of that bank, AND WITH THE VERY CONSENT AND APPROVAL OF THE RENO NATIONAL, PREDECESSOR TO THIS APPELLANT. Is it not certain in law, equity, and business morals, that an assignee or substituted plaintiff, in a case like this, is bound by the acts of his predecessor in interest? If the Reno National, tacitly, openly, and undoubtedly waived any claim to this stock and lulled depositors into a sense of security, may the R. F. C. or the present appellant come along, take the security away, and leave the depositors holding an empty sack? Is it possible that he who seeks equity need not do equity, and innocent depositors, who have no redress here at all, may, in equity, have valuable assets taken away from them without being reimbursed by a single dollar? Does it restore equity and protect the depositors by adopting appellant's contention that the assignee, the Reconstruction Finance Corporation, knew nothing about any water-stock when they loaned money to the Reno National and overlooked interpreting their collateral until long after both banks were closed? It was their duty to examine and construe their collateral

and investigate the facts. If they were guilty of any dereliction, should these depositors be compelled in equity to make good their mistake, and without compensation, part with valuable assets? And if it was the duty of the Reno National to explain to the R. F. C. that the stock was pledged to the Bank of Nevada by the very direction and order of the Reno National, that money was loaned on it, that it was held by the Bank of Nevada, that the Reno National considered it outside and not a part of the Taylor mortgages, and the Reno National failed to perform that duty, who is responsible, the Reno National, or innocent depositors in the Bank of Nevada? Should they have sued themselves or the depositors? Or should the R. F. C. have sued the Reno National for concealing material facts with respect to securities? It seems revolting to all principles of equity that this suit should be maintained against the Receiver of the Bank of Nevada, whose duty it is to protect his depositors.

The same reasoning, of course, applies to the substituted plaintiff, the appellant herein, who is bound by predecessor acts. While the appellant becomes a substituted party through purchase by mortgage foreclosure, the court must not be misled by the belief that the purchase definitely includes the stock in controversy here. Counsel have stipulated that the status of this stock is to abide the final determination of this case. (Tr. Rec., 132-133.)

There is some irony in further contemplation of the

equities involved, which was suggested in the brief and oral argument. Taylor, Inc., gave the Reno National a chattel mortgage encumbering "certain described livestock, machinery, tools, and merchandise upon the lands described in said real property mortgage." (Tr. Rec., 81.) When the same corporation applied for the additional loan from the Bank of Nevada, Mr. Sheean, authorized representative of both banks, endorsed his initials "J. S." on the notes. In addition, he endorsed on one note "taxes and wages," and on another note "shearing." He testified that the loan was made "because it was necessary to furnish Mr. Taylor with some expense money." He also testified that the word "shearing" was in his handwriting and testified "that the request for money was for that purpose." (Tr. Rec., 15-146.) "Expense money" for what? Whose sheep were going to be "sheared"? "Taxes and wages" for what? The answer is plain. The money so borrowed from the Bank of Nevada was to be used to protect the property mortgaged to the Reno National Bank. The corporation owned no other property. Therefore, the money MUST have been used to protect this very property. Taxes due on the real property mortgaged, perhaps some on the personal property mortgaged! Wages to pay employees for taking care of the real and personal property and for shearing the sheep, likewise mortgaged! By this loan, the Reno National Bank was relieved from advancing thirty-two thousand five hundred dollars expense money, and the mortgages assigned to the R. F. C. had that much greater

net value as collateral. Though both the Reno National and the R. F. C. accepted the benefits of this large amount of money for the protection of their own securities, they not only do not make a tender of the money in return, but they bring suit to take away all the collateral besides, and put it in their own coffers for their further exclusive use and benefit.

Therefore, a summary of the point briefly stated is, that the directors here are in fact suing themselves in equity to take away security, which they solemnly and advisedly accepted for one bank, to give it to another bank for the benefit of the latter and to the detriment of the former. As stated in our brief, according to high authority, this is implied fraud. It is believed that this court has the power and authority to order such a suit dismissed, either on its own motion, or by suggestion, if the evidence and the record undeniably disclose a state of facts such as are conceded here.

2.

The Court, In Its Opinion, Did Not Consider the Point Raised In Appellees' Brief, That the Rule of Knowledge or Notice Does Not Apply Here

In a foot-note on page 3 of the opinion, the court states, "It is conceded that the pledgee bank had actual knowledge of the prior mortgages to the Reno National Bank." It is assumed that the fact of notice had some bearing upon

the ultimate conclusion reached by the court. While the statement in the foot-note is literally correct, it takes out of consideration the fact, as we argued in the brief, that knowledge was acquired because the directorate was the same for both banks. It is not the case of a separately managed corporation accepting security with the knowledge that it was pledged to another. The statement of the court followed the contention of appellant, which, it must be observed, disregarded the very important admitted fact of the common directorate. We again respectfully stress the point that the very knowledge of the directors, as to the mortgages referred to, only adds emphasis to our contention that in the face of this knowledge, they approved the stock-collateral for the other bank and waived all right to claim it as pledged to the former bank. They were estopped from denying the validity of a pledge which they had solemnly declared was good and valid, and upon which they loaned a large sum of money.

3.

The Court Inadvertently Disregards Another Important Conceded Fact

It is established, without contradiction, that the corporations, whose shares of stock are in controversy here, OWN NO IRRIGATED LANDS WHATEVER. As the opinion of the trial court discloses (Tr. Rec., pp. 41-42), "None of the corporations, the stock of which is here involved, appears to be the owner of irrigated lands. Such

stock, therefore, does not present any element of interest in rights to water as such; particularly is this the case of the several ditch companies."

It is believed that it is accurate to state that in Nevada, in order to apply the doctrine of appurtenant water, there must first be established some form of title or interest in land, and second, there must be established a given amount of water put to a beneficial use upon the land. Both of these elements are lacking insofar as the certificates of stock here involved may be concerned. The ditch companies own neither water nor land. The Humboldt-Lovelock Irrigation, Light & Power Company owns a reservoir in which are stored flood waters, and which waters are sold to anybody who will pay the price, but Class A and Class B stockholders are given preference as to water and price. (Tr. Rec., 82.) This corporation owns no irrigable lands to which any of its stock could possibly be appurtenant. A purchaser of water from this corporation, which water was placed to a beneficial use, could obligate the corporation to continue furnishing it, as the Prosole case holds, but this would not entitle the purchaser to shares of stock in the corporation. This is substantially what the trial court determined (Tr. Rec., 41) in declaring that "rights to water for irrigation of arid lands within this state are wholly distinct from rights which may be evidenced by corporations' stock certificates. A corporation, except in the case of a water supply, for municipal purposes, may not acquire a title to water for irrigation

except in cases where such corporation is also the owner of the land upon which such water is so used and so becomes appurtenant thereto."

It is believed that this Honorable Court has not taken into consideration that the appellant has not established that these various corporations own any irrigable land to which water may become appurtenant. If the corporations have not acquired any appurtenant water rights, then it must follow that no appurtenant water right attaches to any capital stock of a stockholder therein.

Berg vs. Yakima Canal Co., 145 P. 619.
See particularly pp. 621-622.

4.

The Court Has Apparently Misconstrued the Nevada Water Decree Adjudicating Rights On the Humboldt River

It will be observed from the decree (Tr. Rec., 100), that "neither the Humboldt Lovelock Irrigation, Light and Power Company, Young Ditch Company, Union Canal Ditch Company, or Old Channel Ditch Company are by said decree found or determined to have rights in or to the waters of said Humboldt River stream system, except that Union Canal Ditch Company was found to have certain rights in respect to lands not here involved, which rights are those referred to in the testimony of A. Jahn."

The court evidently recognizes this finding by declaring in its opinion (page 2) that "None of the ditch companies, so far as material here, was adjudged to have any right to divert or appropriate waters of the stream."

It will therefore be noted that these corporations not only did not own any irrigable land, as previously stated, but by the very court decree it was determined that they did not have any rights in or to the waters of the Humboldt River stream system. If they owned no irrigable land and no water, how may it be established in this case that these corporations owned any appurtenant water rights and were depriving the appellant of any? If the corporations owned no appurtenant water rights, then shares of stock in them would represent no such rights. How may appellant recover on the theory of a right to appurtenant water, if the stock it seeks to possess represents neither water nor a water right?

The court in its opinion (page 2), declares, "In the state decree, the right to use the water carried in the distribution systems of the ditch companies was adjudged to be appurtenant to the place of use." While this statement is undoubtedly accurate, may it be respectfully suggested that it may only apply to a holder of land who actually puts water to a beneficial use. It could not apply to these corporations, because, as has been shown, they hold no irrigable land, and they have performed no acts of beneficial use entitling them to a right to water or to

ownership thereof. Their general function is to transport and convey water for other people, including stockholders, to use; and it is not denied that by established authority and precedent, once water is so conveyed and appropriated and placed to a beneficial use by a recipient thereof, the corporations are obligated to furnish such transportation so long as use continues.

5.

It Is Respectfully Submitted That the Court Placed a Construction of the Deed From Taylor to Taylor, Inc., Not Justified By Conceded Facts

The court on page 2 of the opinion, observes that "The deed (from Taylor to John G. Taylor, Inc.) conveyed all the real and personal property of the grantor, together with *appurtenant* water rights, ditches, and canals, 'and all shares of stock of any water corporation *appurtenant* to said land or the waters from which are used or have been used in connection with the irrigation or cultivation thereof'." (Italics ours.)

It will be observed that the deed purported to convey APPURTENANT water rights and shares of stock of any water corporation APPURTENANT to said land. It will also be noted that the expression "the waters from which, etc.," refers to any water corporation APPURTENANT to said land.

It has been shown that none of the corporations whose

stock is here involved owns any water rights appurtenant to the land conveyed. Therefore, the deed could not possibly have conveyed or assigned any of the stock in controversy here. That this was the adopted construction of the deed by Taylor, by Taylor, Inc., and by the Reno National Bank is apparent, for never once, over a period of years, did any of them ever make demand upon Taylor for the delivery of the stock.

The statement in the opinion of the court (page 6), that "His (Taylor's) deed of conveyance to John G. Taylor, Inc., expressly included all water and distribution rights and all shares in water corporations," does not take into consideration that the conveyance was limited to APPURTENANT rights. It is also respectfully suggested that the further declaration of the court (Opinion, p. 6), that "The subsequent attempt of Taylor to pledge the shares are ineffectual, for they were no longer his to pledge," is a conclusion not justified by the facts and record, as above indicated.

6.

The Court Seems Not to Have Taken Into Consideration Essential Matters Upon Which the Trial Court Concluded In Favor of Appellees

On page 3 of the court's opinion, the following is stated:

"The trial judge appears to have believed that the stock in question might represent something of value other than

an interest in the irrigation systems. In his memorandum opinion, he calls attention to the circumstances that the articles of incorporation of the several companies do not disclose that they were organized for the sole or primary purpose of supplying water for the irrigation of any particular land. 'In the case,' said the court, 'of the Humboldt-Lovelock Irrigation, Light & Power Company, as indicated by its name, it was incorporated for other purposes in addition to that of storing and transporting water. Stock therein might necessarily have a value for reasons wholly distinct from the matter of supply water for irrigation of lands'."

This court apparently did not take into consideration other essential facts found by the trial court, namely, that "None of the corporations, the stock of which is here involved, appears to be the owner of irrigated lands. Such stock, therefore, does not present any element of interest in rights to water as such; particularly is this the case of the several ditch companies." (Tr. Rec., pp. 41-42.) The trial court also declared (Tr. Rec., p. 41), that "A corporation, except in the case of a water supply for municipal purposes, may not acquire a title to water for irrigation except in cases where such corporation is also the owner of the land upon which such water is so used and so becomes appurtenant thereto."

This court, in its opinion, appears to have made no

comment upon these factual and legal conclusions of the trial court.

7.

The Court Having Apparently Overlooked Some Essential Facts Established By the Record, Its Conclusions That These Corporations Are Mutual Water Companies, It Is Believed, Should Be Reconsidered

The cases of canal and ditch companies OWNING NO WATER RIGHTS, AND OWNING NO IRRIGABLE LAND, and which are only carrying companies, are to be distinguished from those having rights to water acquired through appropriation. This was the evident distinction made by the trial court as one reason for concluding against appellant's contention that the corporations, whose stock is involved here, are mutual water companies. An examination of the cases cited in support of the court's opinion herein will disclose, it is believed, that in every case in which the fact appears, the corporation involved had appropriated or owned water to furnish to stockholders.

In *Prosole v. Steamboat Canal Co.*, 37 Nev. 154, 140 P. 720, the opinion opens with the statement, "The appellant company, being the owner of the Steamboat Canal HAS FOR MANY YEARS BEEN ENGAGED IN THE BUSINESS OF DIVERTING WATER FROM

the Truckee River and delivering the same to and upon the lands under that canal for a valuable consideration."

In *Twin Falls L. & W. Co. v. Twin Falls Canal Co.*, 9 Cir., 79 F. (2nd) 431, it is stated that "Appellant APPROPRIATED FROM the waters of Snake River for this project, 3,000 second feet * * * on the river."

In re Thomas Estate, 147 Cal. 236, 81 P. 539, the ditch owners and owners of water rights "CONVEYED to the corporation, by deed of grant, the ditches then in use for the conveyance of the water, AND ALL THEIR WATER RIGHTS which may have accrued to said parties by their use of the waters of said creek for irrigation," and in consideration thereof, obtained corporate certificates of stock.

In *Ireton v. Idaho Irr. Co.*, 30 Ida. 310, 164 P. 687, "the contract provided that appellant should SELL TO ENTRYMEN WATER RIGHTS and shares of stock in the Big Wood River Reservoir Canal Company, Limited." The implication is plain that in order to sell water rights, the corporation must have owner or appropriated water.

In re Johnson's Estate, 64 Utah 134, 228 P. 748, involved the construction of a will. The court stresses a greater latitude of construction is justified in the case of a will as compared with a deed, but the fact as to whether the corporation had or had not owned or appropriated water to sell to stockholders is not disclosed by the opinion.

In *Yellow Valley Co. v. Associated Mortgage Investors*, 88 Mont. 73, 290 P. 255, the case was tried on an agreed statement of facts, and these are not set out in the opinion. Neither does the opinion disclose the fact herein discussed. The same observation is therefore made as in the preceding case cited.

In *Burnett v. Taylor*, 36 Wyo. 12, 252 P. 790, an application for a permit to APPROPRIATE water was made by and on behalf of the reclamation company. The corporation was given limited rights to DIVERT and USE this water, which it furnished to its stockholders.

In the case at bar, there was no evidence of diversion or appropriation of water by any of the corporations. There is nothing in the record to show that these stock holdings represented interests in irrigable lands or appropriated water. The most that may be claimed is, that as stockholders, they were entitled to a preferential right to the use of the water-transportation facilities at a minimum preferential cost, and to the use of flood waters from the reservoir, BUT ONLY TO SUPPLY A DEFICIENCY BASED UPON PRIOR USE AND APPROPRIATION BY THE LAND-HOLDER. Other land-holders, not stockholders, could use these same facilities if they paid the cost fixed by the Board of Directors, and if, like the stockholders, they had placed a given amount of water to a beneficial use.

Attention is further invited to the case of *Berg v. Yakima*

Valley Canal Co., 145 P. 619, and particularly p. 622, in which it is held that, "The stock in the extension company did not represent independent water rights, but only the right to carry water obtained from the Oligarchy Ditch Company. It was held that a deed conveying the land, together with all rights to use water for irrigating the premises, did not include stock in the extension company. This company owning no water right, but being only a carrying company, it is plain that the right to have water carried which the stock represented would not pass as appurtenant to the land. There would seem to be a distinction between stock in a ditch company which represented the right to the water which had been appropriated and owned by the company, and stock in a corporation which owned no water rights, and only carried water for its members which they owned, evidenced by certificates of stock in another corporation."

8.

Has the Court Taken Into Consideration Important Evidence In the Case In Determining With Appellant That In the Hands of Appellees, the Stock In Controversy Here Has Only a Nuisance Value?

On page 6 of the opinion, the court states, "In the hands of appellees, these shares possess no more than a nuisance value, but to appellant, they represent indicia of title and the essential right to participate in management." It is a definitely conceded fact that the common directorate

loaned $32,500 on this and other stock. There must be something more than a nuisance value in this. In fact, the appraised value, at the time of the loan, must have been greater than this, for it may be assumed that the bank required some margin of value in the security pledged in order to make the loan bankable. It will also be observed that the loan was made on the stock as such. It will further be noted that the independent value of this security was estimated by the Reno National Bank, sitting jointly with the Bank of Nevada, a predecessor of appellant. How may the Reno National now successfully contend, in the face of the record, that the stock only has a nuisance value, after deliberately appraising it as good and valuable security? If the Reno National would be foreclosed against such a claim, then certainly its assignee and the appellant would likewise be foreclosed.

Attention is also invited to the record-fact, that by authority of the Board of Directors, and otherwise, stock was issued to those NOT LAND OWNERS (Tr. Rec., 123, 124, 126, and 135); that it was pledged to Federal Farm Bank and others (Tr. Rec., 123, 126, 137); that "there have been some sales of the stock between one farmer and another. (Tr. Rec., 127.)

The Reno National, or its successor appellant, now desires to participate in management of these corporations and would deny to the Bank of Nevada such right in protection of the security so pledged. In the face of the

record, is it unreasonable to contend that the right to participate in management should accrue to the bank who holds the security? Also, in the face of the record, has not this right something more than a mere nuisance value?

9.

As a Further Ground for Re-Hearing, It Is Uurged, As Previously Contended In Appellees' Brief, That the Corporate Set-Up and By-Laws Establish That the Corporations Are Not Mutual Water Companies

While it is conceded that, as a general rule, the acts of a corporation often evidence and interpret its purpose, yet, it is respectfully submitted, that it appears from the authorities that this general rule does not apply in determining whether a so-called water-corporation is organized under general corporation statutes or whether it is organized as a mutual water with certain defined limitations and restrictions.

As is declared in a monograph on "Mutual Water Companies," Southern California Law Review, Volume XII, Number 2, January, 1939, page 194, "The form of the articles, by-laws, and the stock certificates have much influence upon the determination as to whether or not the corporation formed is a mutual water company." It is respectfully submitted that the court in its opinion (page 5), apparently disregarded "nomenclature and the formal recital of powers" and based its conclusion solely upon powers

"asserted or exercised." We again refer the court to p. 32, et seq., of appellees' brief, which we believe conclusively establishes by the record that neither the articles of incorporation, the by-laws nor the stock certificates indicate at all that any of these corporations were organized NOT for profit. In fact, the corporations referred to in the brief (page 32) all expressly provide and contemplate in their articles the payment of dividends out of profits. It is stated with confidence, that there is nothing in the corporate set-up, by-laws, or stock certificates which differentiates these corporations from those others organized under the general corporation laws of Nevada. As such, the stock is personal property not appurtenant to any land, not a covenant running with any land and not passing with a conveyance or mortgage of real estate. The rule is definitely stated by a respectable authority (cited in our brief, page 36), as follows:

> "A corporation may provide that the water-right shall be regarded as attached to the land, and shall pass only with it. In the absence of such provision, however, the stock is separate from the land and an execution sale of the land will not pass the stock."
>
> *Farnum on Water and Water Rights,* Vol. 3, Pages 2001-2002.

That the California courts of last resort have seriously considered, as a primal factor, the corporate set-up, the by-laws, and the stock certificates as determinative of the question as to whether a water-corporation is a mutual organization or not, is disclosed by the following cases:

Security Com. & Sav. Bank v. Imperial Water Co. No. 1, 193 P. 22, in which, on page 25, it is stated, "Under these circumstances, we think the proper course to pursue is to reverse the judgment without directions to enter judgment for defendants so that the complaint may be amended, if necessary, to show the true character of said stock and the existing facts regarding the by-laws of the corporation as above indicated."

Riverside Land Co. v. Jarvis, 163 P. 54, wherein the court appears to have determined the controversy, not unlike this case, through an examination and interpretation of the articles of incorporation, the by-laws, and the stock certificates. On page 59 of the opinion, the court states that, "The articles, by-laws, and certificate constitute the evidence of the contract between the parties. Taken together, they are in effect, an agreement between the stockholder and the company that the stock shall be transferable only with the land, and, conversely, that a transfer of the land shall pass to the grantor thereof the right to the stock, that is, the equitable title thereto."

In *Spurgean v. Santa Ana Val. Irr. Co.*, 52 P. 140, the court sets out in the opinion several of the by-laws and "rules" of the corporation and appears to have determined the case upon a construction of the articles, by-laws, "rules," and certificates of stock.

In *Smith v. Hallwood Irr. Co.*, 228 P. 373, the court held the stock in controversy "personal property"

and not appurtenant to the land, and based its conclusions upon the fact that the corporate set-up did not in express terms make the stock appurtenant.

See also, *Consolidated Peoples Ditch Co. v. Foothill Ditch Co.*, 269 P. 915, especially page 920.

John G. Taylor became a stockholder in the various corporations and was bound only by his contract with these corporations evidenced by the "articles, by-laws, and certificates." (*Riverside Land Co. v. Jarvis*, Supra.) He could not convey, transfer, mortgage, or hypothecate any of his stock and by so doing modify the express provisions of his contract. In other words, his stock, by the contract, not being appurtenant to the land, he could not make it appurtenant by violating his contract. Therefore, when he deeded to John G. Taylor, Inc., and conveyed "appurtenant stock," it could not have been the stock in controversy here, because by his contract with the corporations, evidenced by "the articles, by-laws, and certificate(s)," the stock was not made appurtenant to the land. (See Appellees' Brief, 31, et seq.)

WHEREFORE, appellees pray that a re-hearing may be granted herein.

Respectfully submitted,

PLATT & SINAI,

Attorneys for Appellees.